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FISCAL IMPACT STATEMENT

LS 6438

BILL NUMBER: HB 1527

NOTE PREPARED: Dec 27, 2002

BILL AMENDED:

SUBJECT: Military Service Income Tax Deduction.

FIRST AUTHOR: Rep. Kuzman

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: ☒ GENERAL
☒ DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill increases the maximum Adjusted Gross Income (AGI) Tax deduction for income received for military service from \$2,000 to \$3,000.

Effective Date: January 1, 2004.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the increase in the military service deduction. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who receive military service income. The revenue loss due to this bill could potentially total \$1.2 M annually beginning in FY 2005. The revenue loss is expected to increase thereafter by about 0.6% annually.

Background: Under current statute the maximum deduction for income from military service that a taxpayer is entitled to claim is \$2,000. The bill would increase this maximum to \$3,000 beginning in tax year 2004. Data from the Department of State Revenue indicates that 34,476 taxpayers claimed the military service deduction in tax year 2000. These taxpayers deducted approximately \$67.6 M in adjusted gross income. This resulted in a revenue loss of about \$2.3 M in FY 2001. The fiscal impact is based on DOR tax data and census and pay rate data for military retirees, survivors, and active duty and reserve personnel in Indiana reported by the Department of Defense (DOD). Imputed totals for 2001 and 2002 based on the DOD census and pay rate data and actual totals for the military service deduction through 2000 suggest that the retirement

portion of this deduction is increasing slightly by 0.84% annually. The imputed totals also suggest that the active duty/reserve pay component is declining by 0.4% annually. Based on this information the military service deduction is expected to increase slightly by about 0.6% annually. Based on this information, increasing the military service deduction from \$2,000 to \$3,000 could potentially reduce AGI Tax revenue by \$1.2 M in FY 2004 provided the slight trends in the imputed deduction amounts occur. It is assumed that the \$1,000 increase will be claimed by all current taxpayers since 2002 pay rate data from the DOD indicates that the average annual pay for active duty and reserve personnel, retirees, and survivors in Indiana exceeds \$3,000. Some military retirement income (i.e. disability retirement income) is currently not taxable under the federal Income Tax and, as a result, is already excluded from Indiana AGI. Recent DOD retirement pay data does not delineate between taxable and tax exempt military retirement payments to Indiana retirees. However, the proportion that is tax exempt is not expected to exceed 10% of total retirement payments. Thus, the revenue loss from the bill could be somewhat lower to the extent that DOD's military retirement payments to Indiana retirees reflect federally tax exempt retirement income. Since the increase in the military service deduction is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed increase in the military service deduction would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Department of State Revenue Income Tax data; Mike Dove, Department of Defense, Manpower Data Center, (831) 583-2400.

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